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Supreme Court of the United States.

OCTOBER TERM, 1971.

No. 71-873.

UNITED STATES OF AMERICA,
Appellant,

v.

FALSTAFF BREWING CORPORATION,
Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF RHODE ISLAND.

APPELLEE'S MOTION TO AFFIRM THE JUDGMENT BELOW.

Appellee moves this Court to affirm the judgment of the United States District Court for the District of Rhode Island on the grounds that the decision below is supported by the evidence and the question presented upon this appeal is not substantial.

The Principal Question Restated.

Appellant's jurisdictional statement misstates the question presented to this Court. The question should be,

"Was the district court warranted in finding that the government failed to establish by the fair preponder-

ance of the evidence that Falstaff was a likely entrant into, or otherwise a potential competitor in, the New England beer market other than by the acquisition of a brewery with an effective distributor organization and, accordingly, that the acquisition of Narragansett by Falstaff was not likely to, and did not in fact, result in a substantial lessening of competition in the New England beer market?"

Statute Involved.

Section 7 of the Clayton Act, 38 Stat. 731, as amended, 64 Stat. 1125, 15 U.S.C. 18 (1964), is the statute involved and is correctly set forth at page 2 of the Jurisdictional Statement.

Statement.

The Proceedings Below.

On July 15, 1965, Falstaff Brewing Corporation (Falstaff) acquired the assets and assumed the debts and liabilities of Narragansett Brewing Company (Narragansett) in accordance with an agreement dated May 26, 1965 (GX 4).[1] On July 13, 1965, this suit was brought. On motion of Narragansett, the suit was dismissed as to it and judgment was entered accordingly. There was no appeal.

Trial of the action began October 6, 1970, and was concluded October 15. The government relied exclusively

[1] As numerous references will be made herein to the transcript and exhibits introduced below, on January 10, 1972, the appellee requested the Clerk of the United States District Court for the District of Rhode Island to transmit the record to this Court.

References to "DX" are to defendant's exhibits introduced in evidence in the district court, "GX" to government exhibits introduced in evidence in the district court, and "Tr." references are to the trial transcript. Since the pages of the trial transcript are not numbered consecutively through the volumes, references are to the date of each volume. For example, "Tr. 07" refers to the transcript volume of October 7, 1970.

on documentary evidence, excerpts of depositions of principal officers and employees of Falstaff, answers to interrogatories and stipulations in its attempt to prove its case. It presented no live testimony.

The district court found,

> "... [T]he plaintiff has failed to establish by a fair preponderance of the evidence that Falstaff was a potential competitor in said New England market at the time it acquired Narragansett. The *credible* evidence establishes that it was not a potential entrant into said market by any means or way other than by said acquisition. Consequently it cannot be said that its acquisition of Narragansett eliminated it as a potential competitor therein.
>
> "... [T]he Government has failed to establish by a fair preponderance of the evidence that said acquisition by Falstaff will probably result in a substantial lessening of competition in the New England beer market." *United States* v. *Falstaff Brewing Corporation*, 332 F. Supp. 970, 972 (R.I. 1971). (Emphasis added.)

The court went on to hold,

> "... [S]aid acquisition by Falstaff will serve to *improve the competitive position* of the Narragansett brand of beer in the New England beer market which is *intensively competitive*, and enable it to compete successfully with the brands of large, national breweries which dominate said market." (*Id.* at pp. 972-973.) (Emphasis added.)

The Question Presented is Not Substantial.

1. *The sole issue in this case is whether the trial court's findings of fact were clearly erroneous.* The government contends that the trial court applied an erroneous legal

standard in arriving at its finding that the acquisition did not violate section 7 (Jurisdictional Statement, p. 2). Upon careful examination of the Jurisdictional Statement, we conclude that the government's real complaint is that the trial court relied "exclusively" upon evidence of the subjective intent of the management of the acquiring firm.[3] That this is not true appears from the record below and the plain language of the opinion below. *United States* v. *Falstaff Brewing Corporation, supra,* 332 F. Supp. at 972. The government's complaint, moreover, disregards the substantial statistical evidence which was before the trial court and the testimony of witnesses who were not a part of Falstaff's management. It becomes clear, therefore, that the real basis of this appeal is that the government disagrees with the trial court's findings and wants this Court to try the matter *de novo.*

Such requests have been consistently denied.[3] *E.g., United States* v. *Yellow Cab Co.,* 338 U.S. 338, 341-342 (1949); *United States* v. *Oregon State Medical Society,* 343 U.S. 326, 339-340 (1952). The government is bound, as is any other litigant, by the provisions of Rule 52(a);[4] the decision of the trial court may not be set aside unless clearly erroneous. *United States* v. *Yellow Cab Co., supra,* at 341-

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[2] The issue as the government perceives it is stated as follows:

> "The district court relied exclusively upon its evaluation of the subjective intent of the management of the acquiring company. In our view, that standard would seriously undermine the effectiveness of Section 7 of the Clayton Act in preserving competition in the beer and other industries." (Jurisdictional Statement, p. 9; *see also* Jurisdictional Statement, pp. 11-13.)

[3] The instant case is unlike *United States* v. *Pabst Brewing Co.,* 384 U.S. 546 (1966), where the district court granted dismissal under Rule 41(b) of the Federal Rules of Civil Procedure at the close of the government's case. A similar motion was made herein and denied (Tr. 08, pp. 5, 8).

[4] Federal Rules of Civil Procedure.

342. And the trial court's findings are entitled to particular weight insofar as they relate to design, motive and intent. *United States* v. *Yellow Cab Co., supra,* 338 U.S. at 341. The record below supports the district court's finding that the government failed in its burden of proof, and is not, therefore, clearly erroneous.

2. *The government failed to prove by the fair preponderance of the evidence that Falstaff was a potential competitor in the New England beer market and that the acquisition would probably result in a substantial lessening of competition.* To establish a violation of section 7, the government was required to prove by the fair preponderance of the evidence that there had been a "merger between two corporations engaged in commerce and that the effect of the merger may be substantially to lessen competition or tend to create a monopoly in any line of commerce *'in any section of the country.'* " *United States* v. *Pabst Brewing Co., supra,* 384 U.S. at 549. (Emphasis in original.) Falstaff does not contest the fact that a merger between it and Narragansett took place.

It was stipulated that the production and sale of beer was the line of commerce (GX 1, ¶ 5) and that the New England states[5] taken together constituted a "section of the country" (and the relevant market) (GX 1, ¶ 6). The sole contested issue was whether the *probable*[6] result of the

[5] The New England states were stipulated to be Maine, New Hampshire, Vermont, Massachusetts, Connecticut and Rhode Island (GX 1, ¶ 6). The term "New England" should not be considered co-extensive with the term "Northeast" or the term "East Coast Market" which include the New England states as well as Ohio, Pennsylvania, New York, New Jersey and perhaps Maryland and Delaware (GX 10, p. 47). The government wrongly equates New England with Northeast and East Coast (Jurisdictional Statement, n. 8, at p. 6).

[6] We italicize the word *"probable"* because section 7 is concerned with probabilities not mere possibilities:

merger would be to substantially lessen competition in New England in the production and sale of beer.

The thrust of the government's case is that the merger will lead to a lessening of competition in the New England beer market by eliminating *potential* future competition between Falstaff and Narragansett (Tr. 06, pp. 3-4; Jurisdictional Statement, pp. 10-16). The government does not rely upon the elimination of actual competition as Falstaff and Narragansett were not competitors in the relevant market or anywhere else at the time of the acquisition (GX 1, ¶ 14; DX F; Tr. 06, p. 3).

The government advances three theories of potential competition:

(a) That Falstaff was a potential entrant in the New England market independently ("*de novo*")[7] or

(b) That Falstaff was a potential entrant by means of a "toehold" acquisition[8] or

(c) That Falstaff was "standing in the wings" and presented the existing sellers with the threat of entry by one of the foregoing means.[9]

Proof of at least one of the foregoing was essential to establish that the acquisition would have the anti-competitive effect proscribed by section 7.

Falstaff was not a potential entrant into the New England market independently. The government's proof has as

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"[C]ongress used the words '*may be* substantially to lessen competition' (emphasis supplied [by the court]), to indicate that its concern was with probabilities . . . no statute was sought for dealing with ephemeral possibilities." *Brown Shoe Co., Inc.* v. *United States*, 370 U.S. 294, 323 (1962).

[7] *United States* v. *Penn-Olin Chemical Co.*, 378 U.S. 158 (1964).

[8] *The Bendix Corp.* (FTC), 3 Trade Reg. Rep. ¶ 19,288, vacated and remanded on other grounds, *Bendix Corp.* v. *Federal Trade Commission*, F. 2d (6th Cir. No. 20687, October 18, 1971).

[9] *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

its cornerstone the recommendation contained in a study made by Arthur D. Little, Inc., that Falstaff enter the "East Coast Market" (*see* n. 5, *supra*) by building a brewery before 1965 near Baltimore, Maryland[10] (GX 10, pp. 14, 16; Jurisdictional Statement, pp. 13-14). To buttress the Little report, the government refers to Falstaff's desire to enter the New England beer market as part of its attempt to become a national brewer[11] (Jurisdictional Statement, n. 8, at p. 6), and Falstaff's apparent financial ability to undertake the construction (Jurisdictional Statement, n. 15, at p. 14).

The government considers unworthy of mention the uncontradicted evidence (not objected to below) that Falstaff's management never entertained the notion of entering the New England market by building a brewery unless it first had an effective distributor organization (Tr. 07, pp. 17, 71; Tr. 08, pp. 30-31; Tr. 09, p. 106). These were not merely statements of subjective intent but rather resulted from the financial reverses suffered by Falstaff in earlier attempts to penetrate the Detroit, Chicago and Southern California markets (Tr. 09, pp. 104-108; *see also* DX I and J). Because Falstaff was unable to establish an effective distrib-

[10] The government has abandoned an alternate theory of independent entry which it pursued at trial. That theory was that Falstaff could have entered the New England market by shipping from its existing plants (Tr. 06, pp. 19-26). It is well that it abandons it because the evidence established that (a) Falstaff did not have the productive capacity in existing plants to enter in that fashion without creating shortages in its existing markets (Tr. 08, pp. 113-114), and (b) based upon its prior experience involving similar distances, shipping such distances would have resulted in losses (Tr. 13, p. 96).

[11] To a greater or lesser degree this evidence was based solely on statements made by Falstaff's management at their depositions, or in annual reports or press releases. To the extent those statements bear on Falstaff's intent, we would suppose that they are suspect in the government's view (Jurisdictional Statement, pp. 10-12). Or are such statements suspect only when they are unfavorable to the government's case?

utor system in any of these markets, its efforts were a dismal failure.[13]

While the Little report did recommend building new breweries rather than buying (GX 10, p. 108), that recommendation was based upon the assumption that certain technological innovations could be implemented (GX 10, pp. 92-97). On the basis of these assumptions, Little advised Falstaff that it could build a 1,000,000 barrel capacity plant at a cost of $15.93 per barrel of beer produced (GX 10, p. 98). But these innovations were tested by Falstaff and Falstaff was unable "to come up with a satisfactory design" (to implement them) (Tr. 13, p. 17). This fact alone makes suspect, at the very least, the Little cost estimates and the recommendations based thereon.[14]

To prove only that Falstaff had the financial ability to construct a brewery was altogether insufficient. It was incumbent upon the government to prove further that entry in this fashion would be a rational economic undertaking for Falstaff.[15] The evidence demonstrates that it was not.

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[13] The Little study recommended that Falstaff build a brewery in southern California (GX 10, p. 16). Falstaff went so far as to buy land in southern California which it later sold when it became apparent that the demand for its beer could not justify the construction of a brewery (Tr. 09, pp. 107-108).

[14] The implementation of the Little report recommendations were, at least insofar as those dealing with new markets, singly unsuccessful. For example, Little recommended construction of a plant in southern California (GX 10, p. 16) and entry into the Detroit and Chicago markets (GX 10, p. 14).

[15] In considering probable potential entry, one commentator has listed the criteria in the following fashion:

> "The acquiring firm—when judged in terms of its objective capability, its *rational economic interest* and its evidenced interests—should be a likely direct competitor of the acquired firm at some time in the future." Davidow, Conglomerate Concentration and Section Seven: The Limitations of the Anti-Merger Act, 68 Colum. L. Rev. 1231, 1244 (1968). (Emphasis added.)

Dr. Ira Horowitz, an economist with impressive credentials as well as the benefit of extensive studies of the brewing industry, testified that the highest return on net worth Falstaff could expect to make from the construction of a brewery would be less than 6.7%, the lowest return on net worth earned by any major industry in 1969, and well below the 15% return projected by Little (Tr. 08, p. 116; GX 10, p. 18). This minimum return was based on what Dr. Horowitz classified as "exceedingly optimistic" assumptions (Tr. 08, p. 116).[15] But even under such assumptions Falstaff's rate of return would have been well below the approximate 13.2% rate of return it earned in 1964 (computed from GX 3-f).

To achieve this marginal return, Falstaff would have had to sell 850,000 barrels of beer, capturing 13% of the New England beer market in 1965[16] and becoming the third largest seller of beer in a market, the competition in which was characterized by the president of Falstaff as "dog eat dog" (Tr. 09, p. 131).

In the light of this uncontradicted evidence,[17] the govern-

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[15] These assumptions were as follows:

1. That construction of a million barrel capacity brewery could have been completed within three years;

2. That the brewery would have operated for the first ten years at 85% of capacity and at 100% capacity during the next 40 years;

3. That the cost of construction would have been only $20 per barrel capacity; and

4. That Falstaff would have received $1.16 profit on each barrel produced, which margin of profit was in line with the margin achieved by Falstaff during the four years previous to the acquisition (Tr. 08, pp. 115-117).

[16] Computed on the basis of the figures contained in DX F.

[17] In passing, we note that the government requested and was granted permission on two occasions to have government staff economists sit with counsel (Tr. 08, p. 41; Tr. 13, p. 2). These economists did not testify.

ment's assertion that Falstaff would probably have entered the market by the construction of a brewery was not only unproved but was without any basis.

Falstaff was not a potential entrant by means of a "toehold" acquisition. We do not concede the legitimacy of the "toehold" theory in a section 7 case. Regardless of the validity of the "toehold" theory and accepting it *arguendo* as far as this motion is concerned, the government was required to establish that it was *probable* that Falstaff would enter the market in that manner. (*See* pp. 5-6, *supra.*)

The government was content to rest its case on this issue upon the facts that (a) a number of acquisitions were made by Falstaff between 1933 and 1958 (Tr. 06, pp. 90-99; GX 2, pp. 2-7); (b) there were three independent brewers with plants in New England, two with a capacity of 100,000 barrels per year, the other with a capacity of 750,000 (GX 1, ¶¶ 8 and 10); (c) overtures had been made to Falstaff by two of these brewers [18] (Tr. 13, pp. 19-22); and (d) Falstaff had received unsolicited expressions of interest from thirty individuals or firms in becoming distributors of Falstaff beer [19] (GX 9). The government offered no evidence of the capacity of any of these individuals or firms to provide effective distribution. There was affirmative and credible evidence offered by the appellee (which it seems clear the court below accepted as credible) that these brewers lacked effective distributor organizations (Tr. 09,

[18] The government suggests that Falstaff's "attempted" acquisitions of Liebmann & Ballantine are evidence of Falstaff's determination to enter the market through the purchase of a brewer (Jurisdictional Statement, n. 9, at p. 7). To the extent this implies that Falstaff initiated negotiations, it is plainly wrong and without support in the record (Tr. 07, pp. 77-78; 93-94). Furthermore, Narragansett contacted Falstaff and not vice versa (Tr. 09, pp. 115-117; Tr. 14, pp. 7-8).

[19] Of those 30 inquiries, only 19 came from persons already distributing beer in the New England market (GX 9).

p. 106). The essential precondition to entry in the New England beer market in any fashion is an effective distributor organization (Tr. 08, p. 107).

Nor did the government produce evidence that the brewing facilities or the capacity of any of these brewers to operate efficiently was economically attractive to any acquisitor. The government proceeds from this evidence to assert that such a "toehold" acquisition offered Falstaff adequate "economic incentive," leaving a gaping hole between the evidence which it offered and the conclusions which it asks this Court to accept (Jurisdictional Statement, pp. 10, 12, 13).

The record is clear that these three small brewers did not have sufficient brewing facilities or the capacity to be operated efficiently (Tr. 13, p. 22). By the government's own admission, "A New England plant would, to be compatible with efficient operation, require a capacity of at lease [*sic*] one million barrels [per year]." (Jurisdictional Statement, n. 15, at p. 14.) Thus, the government is demanding that Falstaff purchase an inefficient brewer in order to gain entry into the market without demonstrating either that Falstaff would gain economic advantage thereby or that there was any economic incentive for Falstaff to make such acquisition.

Falstaff was not "waiting in the wings" and its alleged presence at the edge of the market did not confront the existing sellers with any threat of entry either "independently" or by "toehold" acquisition.[20] The third and last alternative left to the government to prove the elimination of potential competition was that the merger deprived the New England beer market of the pro-competitive effect of Falstaff's presence at the edge of the market. But as

[20] This theory was alluded to by the government at trial (Tr. 07, pp. 60-61) but is not pressed in its Jurisdictional Statement.

the late Justice Harlan said, concurring in *Federal Trade Commission* v. *Procter & Gamble Co.*, 386 U.S. 568, at 593-594 (1967):

> "... [E]conomic theory teaches that potential competition will have no effect on the market behavior of existing firms unless *present market power is sufficient to drive the market price to the point where entry would become a real possibility.* So long as existing competition is sufficient to keep the market price below that point, potential competition is of marginal significance as a market regulator. Thus in a conglomerate or product-extension case, where the effects on market structure which are easiest to discover are generally effects on the 'condition of entry,' an understanding of the workings of the premerger market cannot be ignored, *and, indeed, is critical* to a determination whether the visible effects on 'condition of entry' have any competitive significance." (Emphasis added.) (Footnote omitted.)

The government's proof on the condition of the premerger market consisted of statistics relating to "market concentration" (GX 1, Exs. O-Z). Standing alone, such statistics are not determinative of the degree of competition (Tr. 08, pp. 93-96; n. 25, *infra*). The objective evidence of the competitive conditions in the market is a better barometer. The record contains evidence of product improvements, packaging innovations and market share instability, all of which tend to reflect the intense competitive situation in the market (Tr. 08, pp. 100-102; GX 1, Exs. O-Z; DX F and H). In addition, the seven largest brewers by sales in the country were selling in that market prior to the merger and no brewer or combination of brewers was able to materially increase the price of beer during a period of rising costs (Tr. 08, pp. 101-102).

Because of this high level of competition, the market was not one which could have been "threatened" with entry by Falstaff.[21]

The government was unable to demonstrate, as it did in *United States* v. *El Paso Natural Gas Co., supra,* 376 U.S. at 655, that Falstaff's actions had some effect on the price of beer or the level of competition in New England. To the contrary, the evidence established that Falstaff in 1964 had no effect on the level of competition in the New England beer market (Tr. 09, p. 26), and further that at least one of its "possible" competitors did not consider Falstaff a competitive threat[22] (Tr. 14, pp. 10-11).

Contrary to the government's claim, therefore, Falstaff was not "waiting in the wings."

The government failed to prove that competition would probably be lessened by Falstaff's acquisition of Narragansett. The ultimate burden on the government, here as in any section 7 case, is to establish that the merger will probably have a significant adverse impact on competition.[23] If the government had been able to prove that Falstaff was a potential competitor in the market, or alternatively that its mere presence had some beneficial impact on the degree of competition in the New England market, it

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[21] At the time of the acquisition, the boundaries of Falstaff's markets insofar as these boundaries are relevant, were western Ohio and Richmond, Virginia. Except for insignificant sales in the District of Columbia, Falstaff did not sell any beer at any place closer to New England (Tr. 09, p. 115).

[22] Carl Haffenreffer, Vice-President and Director of Marketing for Narragansett prior to 1965, put it as follows:

> "We certainly didn't consider them [Falstaff] any threat to us. We had much greater threats to concern ourselves with. Certainly, at that distance, they were no threat because of the transportation costs." (Tr. 14, pp. 10-11.)

[23] S. Rep. No. 1775, 84 Cong., 1st Sess. 1950, U.S. Code Cong. and Ad. News, vol. 2, p. 4298; *United States* v. *Pabst Brewing Co., supra,* 384 U.S. at 562 (concurring opinion of Justice Fortas).

would have remained for it to establish the likelihood and substantiality of an adverse competitive effect resulting from the merger.

The government did not produce any evidence bearing on the adverse effect,[24] except for evidence of "concentration" which has little or no probative value in measuring the level of competition.[25]

In measuring the merger's effect on competition, the trial court had to consider whether (a) the merger led to increased concentration in the market, or (b) as a result of the merger, Falstaff increased its market power, *i.e.*, control over prices.[26] The post-acquisition evidence[27] reveals that since the merger, beer prices have remained constant, relative to costs (Tr. 08, p. 109). Had Falstaff been able to exert any control over prices, it would have used that control to increase Narragansett's share of the New Eng-

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[24] There is no *per se* rule of illegality in cases involving market extension mergers. *See* Anti-Trust Developments, 1955-1968, A Supplement to the Report of the Attorney General's National Committee to Study the Anti-Trust Laws (1968), at pp. 86-87;

[25] It is true that concentration may be a signal of possible deviation from competitive behavior but further study is required in order to ascertain the actual existence of any deviation from competitive norms (Tr. 09, 50-51).

[26] These alternative tests have been suggested as measures against which to judge the effect of "geographic extension mergers" on competition in any market. *United States* v. *First National Bank of Jackson*, 301 F. Supp. 1161, 1189-1190 (S.D. Miss. 1969). The instant merger is a "geographic extension merger" in that it involved two firms producing a similar product in separate geographical markets in which they were not direct rivals. *Id.* at 1190.

[27] The government objected to the admission of post-acquisition evidence and this objection was overruled (Tr. 08, pp. 37-41). The district court's ruling on the objection was proper. See *e.g.*, *United States* v. *Pabst Brewing Co.*, *supra*, 384 U.S. at 550-551; *Federal Trade Commission* v. *Consolidated Foods Corp.*, 380 U.S. 592 (1965).

land market or its profits. To the contrary, since 1964, the year preceding the merger, Narragansett's share has fallen from 21.5% to 15.5%, and its profits have declined (DX F and H; Tr. 09, pp. 25-26, 110; App. A and B).

The record in this case supports the finding below that the merger, if it had any effect on competition, did not have the effect of lessening (substantially or otherwise) the highly intense competition that characterizes the New England beer market.

Conclusion.

The appellee moves this Court to affirm the judgment below on the grounds that the question presented is unsubstantial and that the judgment does not warrant review. *Chicago, Rock Island & Pacific Railway Co.* v. *Devine*, 239 U.S. 52, 54 (1915); *Bodkin* v. *Edwards*, 255 U.S. 221, 223 (1921).

Respectfully submitted,

MATTHEW W. GORING,

JAMES S. McCLELLAN.

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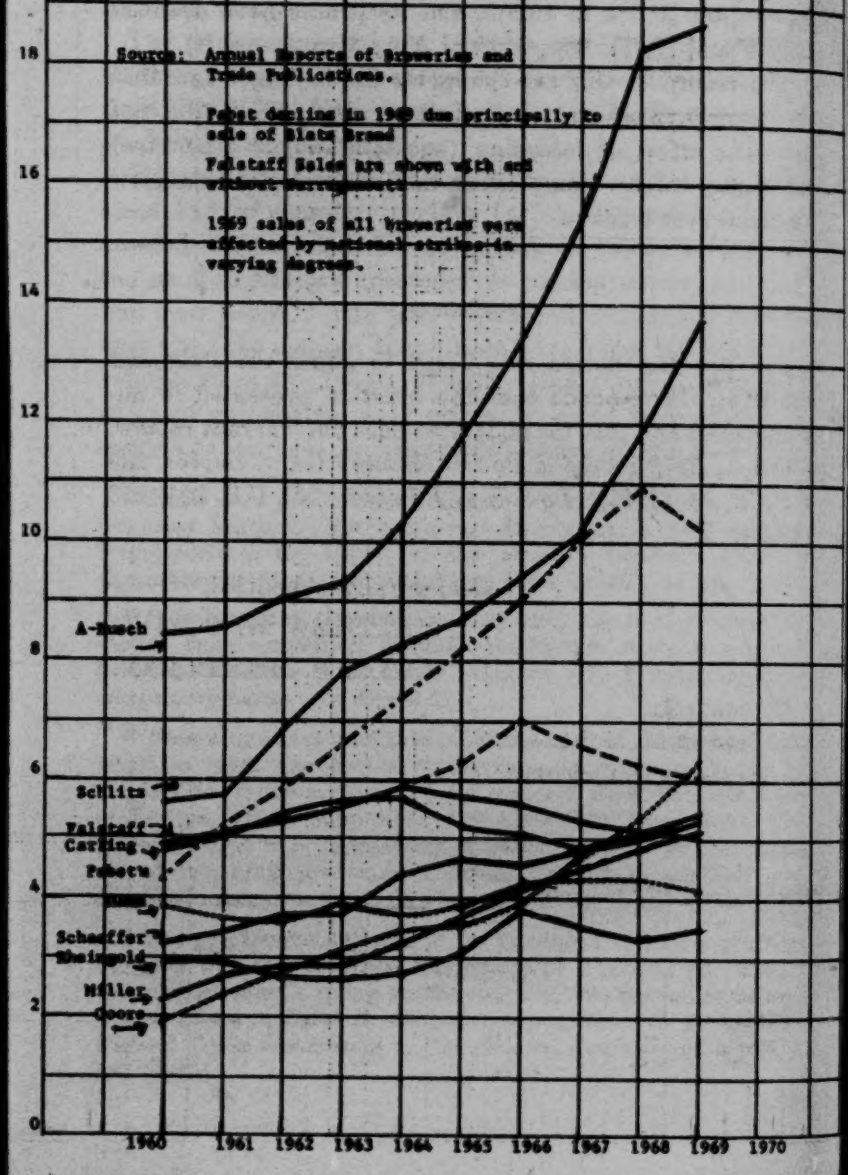
JEROME M. McLAUGHLIN,

STEPHEN J. CARLOTTI.

NATIONAL BARREL SALES
BY BREWERS - 1960-1969

APPENDIX A (DX G)

(Each Line = 100,000 barrels)



NEW ENGLAND BARREL SALES APPENDIX B (DX H)
BY BREWERS - 1964 to 1969